

ANALYSIS OF ORIGINAL BILL

Author: Kuehl Analyst: Gloria McConnell Bill Number: AB 2014

Related Bills: See Legislative History Telephone: 845-4336 Introduced Date: 02/18/98

Attorney: Doug Bramhall Sponsor:

SUBJECT: Independent Contractor Registry/Service Recipients Report Information to
Employment Development Department

SUMMARY

Under this bill, any trade or business, including public agencies, filing a federal (and state) annual information return because they made payments of \$600 or more during the past calendar year for personal services, generally would be required to report the same information to Employment Development Department (EDD) on an accelerated basis. The report would be required the earlier of 20 days after entering into a personal service contract or first paying amounts in excess of \$600 during the calendar year. This information source would be available to Franchise Tax Board (FTB) for child support and tax enforcement purposes.

This analysis presumes FTB routinely would incorporate this information source into its automated collection processes. For purposes of this analysis, these persons performing the reportable personal services will be termed "independent contractors."

EFFECTIVE DATE

This bill would be operative on January 1, 1999.

LEGISLATIVE HISTORY

AB 573 (Kuehl; Stats, 97. Ch. 599).

PROGRAM HISTORY/BACKGROUND

The EDD administers various employer reporting programs. Under the Unemployment Insurance Code (UIC), employers are required on a quarterly basis to report to EDD information on their employees, which includes the employee's social security number (SSN). EDD's employer/employee information is available to FTB shortly after the end of each quarter. In addition, certain employers are required to report an employee's name and SSN to EDD within 30 days (as of July 1, 1998, all employers will be required to report within 20 days or twice a month if reporting

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___ X ___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department Director Date
Gerald H. Goldberg 4/7/98

Agency Secretary Date

By: Date

electronically) of the hiring, rehiring or return to work of an employee. The new-employee registry (NER) can be used for child support enforcement and collecting unemployment benefit overpayments and personal income tax enforcement. The NER law was enacted to aid in the collection of debts of individuals who were able to avoid collection because the quarterly return information was received too late to be used as an effective collection information resource. EDD may impose a penalty against employers that fail to report new employees as required.

For both income tax and child support collection purposes, if a delinquency is unpaid, FTB (and district attorneys) matches EDD's quarterly employee information file against its files. If the tax debtor or child support obligor is identified as an employee, an earnings withholding order is issued against any earnings of the debtor or obligor. For the NER, EDD requires that it perform the match, and FTB must send a copy of its file to EDD, which is done twice a month for child support collection purposes. However, for tax collection purposes, because of the enormous size of FTB's tax accounts receivable file, the department has not been able to participate in the EDD NER process. Therefore, FTB and EDD staff are looking at alternative processing.

For child support collection purposes, whether the compensation is wages or payments to become due for personal services, the compensation is considered "earnings." As such, 50% of the individual's disposable earnings are subject to garnishment for purposes of collecting child support delinquencies. For tax collection purposes, however, generally 25% of wages or payments to become due for personal services are subject to garnishment. When FTB issues an earnings withholding order, the recipient of the order, by law, is required to deliver a copy of the order to the debtor and begin withholding the first pay period that ends at least 10 days after receipt of the order. Withholding orders issued by district attorneys have similar provisions.

This bill, in general, introduces the provisions that were in AB 573 last year, as amended August 25, 1997. These provisions were removed as the bill was amended September 4, 1997, and replaced with a requirement that the EDD, in consultation with the Department of Social Services and FTB, prepare and submit a study to the Governor and Legislature no later than June 30, 1998, that identifies possible methods for establishing a state mechanism for the reporting of income of service providers for the purpose of collecting child support obligations. The study must include recommendations as to the most feasible and cost effective reporting methods.

SPECIFIC FINDINGS

Under Section 6041A of the Internal Revenue Code (IRC), persons in a trade or business (service-recipients), which includes state agencies, that pay \$600 or more for personal services during a calendar year to an independent contractor are required to file an information return (1099-MISC; nonemployee compensation) with the IRS by February 28, following the close of the calendar year. The 1099-MISC contains the following information:

- the name, address, and federal identification number of the person filing the information return,
- the name, address and identification number of the independent contractor (SSN in the case of an individual), and
- the aggregate amount of the payments made to that person.

For California purposes, service recipients are required to send a copy of their federal 1099-MISC to FTB at the same time it is required to be filed with the IRS. If a service recipient has more than 250 independent contractors, the 1099-MISC copy must be filed with FTB on magnetic media, which is generally available for FTB to access by May or June. If the service recipient has fewer than 250 independent contractors, it may elect to file a combined federal/state 1099-MISC or file a paper information return. In the case of a combined or paper information return, IRS shares the information with FTB, and this information is generally available for FTB access by November.

Under this bill, service-recipients who are required to file an independent contractor information return under Section 6041A, which include state agencies, would accelerated that reporting (the earlier of 20 days after entering into the personal service contract or, if no contract, first paying \$600 or more) and also report to EDD the same information required on the 1099-MISC described above, plus the following additional information:

- the date of the contract or, if no contract, the date that payment first totals \$600 or more, and
- the total dollar amount of the contract, if any, and the contract expiration date.

Under current law, the NER information is retained by EDD for no more than six months after the calendar quarter.

Under this bill, the ICR information would be retained by EDD for 10 months after the close of the taxable year, which is generally the time that the 1099-MISC would be available.

Implementation Considerations

FTB staff anticipates the Independent Contractor Registry (ICR) would be used for child support and tax collection purposes in the same form and manner that it uses EDD's NER. If the ICR information is matched to an obligor whose delinquency has been referred to FTB for collection, FTB would issue an earnings withholding order to the contracting trade or business, which could include state agencies. Though currently the NER process is not compatible to FTB's needs for tax collection purposes, as previously discussed, staff anticipates that current discussions with EDD will overcome this complication, and if this bill is enacted the ICR, likewise, would be used for tax collection purposes.

Staff has identified the following considerations that may ease the implementation and administration of the ICR and thereby enhance its usage by FTB. The suggested amendments are attached for your convenience:

- To avoid misinterpretation, the bill could clarify that only businesses would be subject to these reporting requirements. (Amendments 1 and 2)
- To avoid confusion as to when to report information on the independent contractor and when the EDD retention period begins, the bill should clarify that the report to EDD and retention period by EDD would be triggered on the date the aggregate payments for the calendar year to the individual first equal or exceed \$600. (Amendment 3 and 5)

- To ensure that the identification number required by EDD could be used for FTB's programs, the bill should provide that the identification number required by EDD would be agreeable to the FTB. (Amendment 4)

FTB, as a contracting public agency, is considering how the reporting of this contract information to EDD would be implemented as required under this bill. A plan will be adopted as the bill moves through the legislative process.

FISCAL IMPACT

Departmental Costs

Currently, EDD charges FTB for its use of the New-Employee Registry for child support purposes. FTB staff estimates the costs to use the ICR per fiscal year could be in the \$10,000 range and would be included in the child support collection program's annual budget.

Costs associated with the reporting requirements and the processing of any withholding orders that may be received within the department as a result of the matching of data between FTB and EDD will be included in the analysis as the bill moves through the legislative process.

Collection Estimate

Based on the discussion below, the amount of additional collections from the provisions of this bill are estimated as follows:

Estimated Collections Impact AB 2014			
Effective 1/1/99			
Fiscal Year Impact			
(In Millions)			
	1998-9	1999-0	2000-01
Child Support Collections	\$1	\$5	\$8
Tax Collections	\$2	\$7	\$14
Total Collections	\$3	\$12	\$22

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Collection Discussion

This estimate does not take into consideration collections of child support obligations by district attorneys that may increase as a result of this reporting change.

This estimate is based on the results of FTB's child support collection program and the available information on 1099 non-employee compensation reporting under current law. This estimate assumes FTB would use the ICR to issue withholding orders for both its child support and tax collection programs. In addition, the following data and assumptions were used:

- EDD will be able to process the service-recipient information within 30 days of receipt in a format that can be used to match records submitted to FTB.
- FTB and EDD, in cooperation, will be able to develop the necessary procedures and programs for matching the service-recipient's information file against FTB's accounts receivable file.
- The maximum compliance rate by service recipients will be two-thirds reached by the third year (22% the first year, 44% the second year).
- In the first year adjustments were made to eliminate pre-existing contracts and to allow for implementation lags.
- The average contract period will be six months.
- Average collection amounts for service-providers were based on total child support and tax collections through the issuance of withholding orders to employers divided by total income tax returns with reported salaries and wages, increased by 50% to reflect the generally higher income levels of service-providers.

BOARD POSITION

Pending.

FTB's Suggested Amendments
AB 2014, As Introduced February 18, 1998

AMENDMENT 1

On page 2, line 13, after "deriving" insert:

trade or business

AMENDMENT 2

On page 2, line 14, strike out "whatsoever" and insert:

in the course of a trade or business

AMENDMENT 3

On page 2, line 28, strike out "of" and insert:

that in the aggregate equal or exceed

AMENDMENT 4

On page 3, line 3, after "Department" insert:

with the concurrence of the Franchise Tax Board

AMENDMENT 5

On page 3, lines 5 and 6 and 12 and 13, strike out "payments first total six hundred dollars (\$600) or more" and insert:

aggregate payments first equal or exceed six hundred dollars (\$600)